

NATIONAL SECURITY COUNCIL

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August 23, 1973

MEMORANDUM FOR: HAL SONNENFELDT

FROM: PHIL ODEEN

Hal -

Enclosed is a revised memo on budget limitations. We have fairly substantially reordered it and have done a good bit of editing. Also, a table is included. I hope this better suits Henry's needs.

DIA review
completed.

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(With Attachment)

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NATIONAL SECURITY COUNCIL

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August 22, 1973

MEMORANDUM FOR DR. KISSINGER

FROM: *PO* Phil Odeen/Helmut Sonnenfeldt

SUBJECT: Mutual Budget Limitations

You asked for further discussion of U.S. - USSR limitations on defense budgets together with a list of key questions that should be addressed.

There are several key issues which should be considered before determining the possible value of such limitations:

- What purposes would a specific limitation be designed to serve?
- How would the defense budget be defined?
- How would the limitation be verified?
- How would inflation be handled?

Purposes

There are three purposes which could be served by a mutual limitation on U.S.- USSR defense budgets:

(1) To reduce the Soviet defense budget. However, as discussed below, there are severe problems of verification and of definition of the Soviet defense budget. If adhered to, a mutual limitation would restrain Soviet defense spending, which has increased about 2% annually over the last several years.

(2) To reduce our own defense budget. However, the lack of verifiability of a limitation on the Soviet budget would make use of the limitation to reduce our own budget politically unsupportable. ...

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GDS

Classified by Philip A. Odeen

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(3) To complement a decision, made for other reasons, to freeze or reduce our defense spending. It would be of value in two ways. First, by "bringing the Soviets along", the mutual limitation would garner some relatively cheap political benefits; and, second, by the fact of having the agreement, it would set clear cut limit for defense planning (and possibly a floor of sorts on Congressional reductions). A ceiling also may -- depending on the length of a mutual limitation -- increase pressures for restructuring of remaining forces to increase their efficiency and for reducing waste in procurement.

How Would the Defense Budget Be Defined?

There are two sets of definitional problems:

First, a limitation on the U.S. defense budget could limit either outlays (i.e., the checks actually written) or new spending authority (i.e., the new funds requested from the Congress). Both measures have some advantages and some drawbacks.

-- Outlays are the measure people most frequently consider when they talk about defense spending. Since this is in fact the most concrete measure, it would be most widely understood. Also, we have considerable ability to manage outlays, shifting them from one year to another, and therefore we may be able to work our way around specific problems that arise. A more fundamental difficulty is that we have obligated money in past years to buy weapons and other equipment, but the actual spending does not occur for several years, as the material is delivered. Given the growth in defense spending over the past two years and the numerous modernization programs that have been embarked on -- especially Navy programs, which typically take many years to complete -- we have substantial backlogs which must eventually be spent. As a result, limiting spending to previous years' levels may lead to cuts in manpower and forces in order to hold outlays to the level prescribed in the mutual budget limitation.

-- Limitations on new spending authority would not suffer from this disadvantage. However, we normally are cut by \$3 or \$4 billion by the Congress and, therefore, if the limitation were to hold our budget request to that actually appropriated by the Congress the previous year we might find ourselves being cut by the Congress well below the prior year's level. The currently approved five-year defense program, in fact, essentially extends current spending levels over the next five year period without any

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increase in real spending value. Thus, agreement to limit defense spending to the current levels would not seriously impede our currently planned programs.

The second definitional problem arises from the fact that the defense budgets of the two states are not fully comparable.

-- The most significant differences are that the Soviets do not include defense R&D in their defense budget and that we do not include nuclear warhead cost in our defense budget.

-- As noted above, any limitation -- if adhered to -- would restrain the Soviets, as their defense budget has increased about 2% annually over the last several years. However, most of this growth has been in the R&D area, which is not part of the spending total called "defense" by the Soviet Union.

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How Would Inflation Be Handled?

The impact of inflation would be different depending on the type and duration of the budget limitation. In a "mutual example" approach we should be able to set our own conditions regarding inflation, as long as these were reasonable. A formal agreement would likely need to include some provision for inflation escalation, especially if it were to extend more than a year or two.

An agreement which extended beyond a year or two would, in fact, involve some reduction in real defense spending, given the inflation and the pay raises that would undoubtedly take place beyond that period. Thus such an agreement would have to allow for inflation or it would necessarily result in a steady and substantial reduction in defense spending, perhaps without any real limitations on the Soviets. There are a number of indices that could be used to measure the increases that the U.S. would be permitted to make to account for pay raises and inflation and the cost of goods. For personnel costs, the size of our annual pay increases is widely publicized and could be used. There are a number of widely reported indices on cost in the industrial sector that could be acceptable to the Soviets as a measure of that aspect of the problem. However, we expect that it would be very difficult for the Soviets to accept an agreement which allowed our defense budget to escalate -- even if only to take inflation into account -- while their budget remained level.

To illustrate the importance of considering inflation in any agreement to limit defense spending, the following table lays out actual defense spending for fiscal years 1964 and 1972 together with projections for fiscal years 1974 and 1978. Both constant (i.e., with inflation taken out) and current dollars are shown.

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	<u>Defense Spending (Outlays)</u> (in billion \$)			
	<u>FY 1964</u>	<u>FY 1972</u>	<u>FY 1974</u>	<u>FY 1978</u>
<u>Current Dollars</u>	50.8	76.0	79.0	99.5
<u>Constant FY 1974 Dollars</u>	87.7	85.7	79.0	83.0

As the table illustrates, current defense levels of \$79 billion are 10% lower, in constant dollars, than the pre-Vietnam spending levels of \$50 billion. At the same time, current levels are 50% higher in current dollars. Moreover, four years from now, assuming no increase in real defense spending, the defense budget would have to total nearly \$100 billion just to cover expected pay raises and price inflation.

Key Questions

This analysis suggests that there are a number of questions that need to be answered before U.S. interest in mutual budget limits can be established:

1. How could we verify or defend budget limitations agreements? Would the Soviets help facilitate verification, and if so, how?
2. Would the Soviets be willing to include military R&D in the budget limitation even though they leave this out of the defense budget and include it under the science budget? How could we verify this?
3. Would the Soviets be prepared to accept an elastic agreement that permitted us to increase our budget to account for inflation and for weapons systems to which we are already committed?

In addition to these questions, we have to consider the major question of what effects such an agreement would have on our policy towards our allies and, specifically, on the defense efforts of our allies. We will also have to consider the effects on the Congress in arriving at a net judgement about the desirability of defense budget limits.

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Attached is a CIA report giving a monetary comparison of Soviet and U.S. defense activity. It goes into detail on many of the problems discussed above and is worth scanning.

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Director, Program Analysis
National Security Council Staff

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These reports provide the most comprehensive treatment of Soviet defense expenditures yet undertaken by OSR. Volume I examines Soviet programs as they would appear to the Soviet planner, measuring expenditures in terms of rubles. Volume II estimates the dollar costs to reproduce Soviet defense forces and programs in the US in order to establish a basis for comparing levels of effort between the US and the USSR.

Bruce Clarke
BRUCE C. CLARKE, Jr.
Director
Strategic Research

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Intelligence Report

Soviet Spending for Defense: An Annual Review

*Volume II. A Monetary Comparison of
Soviet and US Defense Activity*

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SR IR 73-12
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